



International Monetary and Financial Committee

Twenty-Second Meeting
October 9, 2010

Statement by James Michael Flaherty, Minister of Finance, Department of
Finance, Canada

On behalf of Antigua and Barbuda, Bahamas, The, Barbados, Belize, Canada ,
Dominica, Grenada, Ireland, Jamaica, St. Kitts, St. Lucia, St. Vincent

Washington, DC, October 9, 2010

Statement Prepared for the International Monetary and Financial Committee of the Board of Governors of the International Monetary Fund

The Honourable Jim Flaherty, Minister of Finance for Canada, on behalf of Antigua and Barbuda, the Bahamas, Barbados, Belize, Canada, Dominica, Grenada, Ireland, Jamaica, Saint Kitts and Nevis, Saint Lucia, and Saint Vincent and the Grenadines

We agree that the International Monetary Fund (IMF) played an important role in helping the global economy through the financial crisis and towards recovery, particularly through fostering international economic co-operation. With a new set of global economic challenges lying ahead, the Fund will have an important role to play in ensuring a healthy and well-balanced international monetary system. It will do this by promoting sound economic policy frameworks; providing financial assistance when needed that strikes the right balance between financing and adjustment; and sustaining co-operation and consultation among its members.

In doing this the IMF must ensure that the proper steps are taken to protect against another severe financial crisis. The IMF can play a critical role in promoting an open international monetary system that facilitates timely, orderly exchange rate adjustment. Future IMF reforms, particularly to the Fund's lending instruments and resources, can help to prevent future crises, but must also encourage members to adopt sound policy frameworks.

Canadian Developments

The Canadian economy continues to recover from the deepest global recession since the 1930s. Real gross domestic product (GDP) in the second quarter of this year increased by 2.0 per cent, after posting gains of 5.8 per cent in the first quarter and 4.9 per cent in the fourth quarter of 2009. The economic recovery has been underpinned by Canada's Economic Action Plan as well as a strong recovery in private domestic activity. As a result of this strong performance, Canada has virtually recouped real economic activity lost over the recession, the only Group of Seven (G-7) country to do so. Canada's solid economic performance has also supported a recovery in the labour market, as all of the jobs lost during the recession have been recovered.

The priority of the Government is to complete the implementation of Canada's Economic Action Plan—a two-year C\$62-billion plan (equivalent to about 2 per cent of GDP on average per year) to support economic growth and create and maintain jobs.

To maintain and preserve Canada's strong financial position, the Government is committed to return to budgetary balance over the medium term, consistent with the G-20 commitment to halve deficits by 2013 and stabilize or reduce government debt-to-GDP ratios by 2016. In Budget 2010, the Government set out a three-point plan to bring Canada's finances back to balance over the medium term. First, it will end the temporary measures as scheduled in early 2011. Second, targeted measures to restrain the growth of

direct program spending have been put in place. And finally, the Government is undertaking a comprehensive review of its administrative functions and overhead costs in order to secure further efficiencies and savings.

Irish Developments

Irish Economic Developments

Turning to the Irish situation, following two exceptionally difficult years it now appears that the economy will record some marginal increase in activity this year. The exporting sector is leading the way, in part a reflection of the substantial—and necessary—competitiveness adjustments that have occurred over a relatively short timeframe. An encouraging feature has been the broadening of the export base in recent quarters, which bodes well for the future.

Domestic demand, however, lags behind. Excess supply continues to weigh on residential investment and will continue to do so for some time. Household spending remains subdued, on the back of declining real incomes and weak confidence. Having said that, the latest labour market data point towards stabilization.

Apart from supporting the banking sector, the most pressing issue is the need to ensure the public finances remain on a sustainable path. While revenue and expenditure plans for this year are in line with expectations, the underlying deficit—that is after excluding one-off issues related to the banking sector—will nevertheless be of the order of 11.9 per cent of GDP. The Irish Government has recently reiterated its commitment to reducing the headline deficit to below 3 per cent of GDP by 2014, and will publish a four-year budgetary plan setting out the annual consolidation measures necessary to achieve this early next month. This is to be welcomed, as it will underpin confidence and credibility in the sustainability of the public finances in Ireland, and as such help support economic growth over the short and medium term.

Irish Banking Developments

The Irish Government has recently reiterated its strong commitment to restoring the Irish banking system to health. This involves a number of actions, some of which have already been undertaken, with more planned by the Irish Government. A Government guarantee of banks' liabilities has been extended to ensure the banks remain able to access the necessary liquidity. The Irish Government has worked to provide certainty on the final costs of repairing the banking system. The National Asset Management Agency provides a facility to ensure that the losses of participating institutions are recognized upfront and that the most impaired loans are removed from their balance sheets. Together with the capitalization of the banks and the resolution and reorganization of the most impaired institutions, this should allow the banking system to play its essential role in providing the finance required to underpin economic recovery and fiscal sustainability. In addition, the Central Bank of Ireland has replaced the previous dual structured Central Bank and Financial Services Authority of Ireland. The new structure has a unitary board chaired by

the Governor with a specific focus on prudential regulation, protecting consumers and maintaining the financial stability of the financial system.

Caribbean Developments

While the economic outlook has improved for members of my Caribbean constituency, medium-term growth is expected to be subdued and below the Western Hemisphere average. Meaningful strengthening is not expected until 2011, underpinned by only modest prospects for tourism and foreign direct investment (FDI) inflows. There are considerable downside risks, mainly associated with lowered expectations for the primary trading partner, the United States, amid household sector deleveraging and weak employment trends. The impetus from Europe is also likely to be mild, as households adjust to fiscal austerity measures. The Caribbean region also expects greater challenges in attracting FDI inflows as global flows normalize at below pre-crisis levels. Caribbean authorities believe that structural reforms to improve the business environment can help to improve these prospects, as can effective and well-targeted public sector investment programs. They acknowledge that reforms must occur within a framework of fiscal consolidation to reduce high debt burdens and to enhance the economies' resilience to future shocks. While three Caribbean countries have taken on IMF programs to guide the adjustment processes, the region's engagement with the Fund has more generally intensified through the Fund's heightened surveillance activities and the increased technical assistance being provided, particularly through the focused work of the Caribbean Regional Technical Assistance Centre.

Enhancing financial sector resilience and stability is a top priority for the Caribbean. The authorities are intensifying their efforts to strengthen and consolidate the supervision of non-bank institutions, and to fortify bank balance sheets against weakened credit quality and strained liquidity conditions. Co-operation among supervisors and regulators is also advancing more vigorously, given the increasing regional connectedness of the financial system—underscored by the need for a speedy resolution to failed insurance sector operations, which spanned multiple jurisdictions. Many Caribbean authorities are also strengthening their international co-operation mechanisms, having concluded a significant number of Tax Information Exchange Agreements to improve their standing with the Organisation for Economic Co-operation and Development. They continue to urge, however, that global initiatives to promote transparency and financial stability do not impinge upon the ability of legitimate jurisdictions to benefit from the provision of international financial services.

IMF Reform

Since the onset of the crisis, a range of surveillance and lending reforms have been put in place. These reforms have added to the Fund's existing tools for safeguarding the stability of the international monetary system. The challenge now is to utilize these reforms to assess the risks to global financial and economic stability arising from unsustainable global imbalances and possible financial sector vulnerabilities. Reforms to IMF surveillance and the scope of IMF lending can help to prevent future crises. In

addition, complementary reforms to the Fund's governance structure are required to ensure that these tools are used appropriately.

Surveillance

We are encouraged by recent efforts to enhance the quality and substance of Fund surveillance. Last year's introduction of the Early Warning Exercise and revamping of the Financial Sector Assessment Program should help facilitate the identification of vulnerabilities stemming from the financial sector and global imbalances in a timely fashion.

Future reforms to the substance of Fund surveillance should focus on further enhancing analysis, particularly through more extensive examination and clarification of the risks arising from global imbalances. Specifically, Fund analysis of cross-country spillover effects, the impacts of precautionary reserves accumulation, financial sector vulnerabilities, and international capital flows will be critical. Existing bilateral and multilateral surveillance products should be relied upon as much as possible so as to streamline analysis. The IMF Statement of Surveillance Priorities in particular can guide Fund surveillance and be a vehicle for Governors to set strategic surveillance priorities and promote accountability.

Lending Instruments and Fund Resources

Recent reforms have dramatically altered the Fund's lending toolkit and substantially strengthened the provision of global financial safety nets, providing a range of options for countries seeking financial assistance. In addressing the liquidity concerns and balance of payments problems resulting from, and laid bare by, the global economic crisis, the IMF substantially expanded its available resources and introduced new and improved lending instruments. The New Arrangements to Borrow (NAB) was increased to US\$500 billion, there was a US\$250-billion general Special Drawing Rights allocation, and the Flexible Credit Line (FCL) was introduced. More recently, the Fund has reformed the FCL and created a new Precautionary Credit Line.

These reforms represent significant change. Before undertaking further significant changes, we need to ensure that the proper governance structures are in place to maintain accountability and due oversight for IMF programs. Much of the financial sector reform effort of the G-20 is aimed at reducing incentives to take undue risk. We must work to ensure this is also the case at the country level.

Similarly, a further increase in quota resources will be necessary in order to realign relative quota shares as part of the current quota review, but the size of the aggregate increase should reflect the need to restore the adequacy of IMF resources without expanding overall Fund resources so far as to spur excessive risk-taking. To this end, a substantial increase in the aggregate IMF quota should be offset by a scaling back of NAB resources, in line with the membership's calls to maintain the Fund's status as a quota-based institution.

Voice and Representation

One of the main elements of IMF reform centres on efforts to enhance the legitimacy of the institution by ensuring that all members are properly represented. The current quota review, together with possible reforms to the structure of the IMF Executive Board, will be instrumental towards a more proper alignment of member countries' voice and representation with their global economic weight, while protecting the voting power of the Fund's poorest members.

Securing a new quota deal that meets the Pittsburgh commitments will require a significant element of compromise and pragmatism. As a first step, it should remain a priority for those members that have not already done so to ratify the 2008 quota agreement. Implementation of this agreement will increase the voice and representation of emerging markets and developing countries through the increase in quota, the increase in basic votes, and the introduction of second alternate Executive Directors for large multi-country constituencies.

Quotas constitute the bulk of overall voting power at the Fund. They also represent the financial obligation of each member and have a bearing on access to Fund financing. With such heavy responsibilities, it is essential that quotas properly reflect global economic weight, and align incentives in a manner that promotes fundamentally sound economic policies that are consistent with strong, sustainable and balanced global growth.

In addition to quota reform, implementing changes to the landscape of the IMF Executive Board is another way of enhancing the Fund's role in the global economy. In particular, it is clear that the voice and representation of emerging market and developing economies at the Executive Board needs to increase. We must do our best to ensure that the IMF membership is most appropriately represented at the table.

Corporate Governance Reforms

A number of other governance reforms can help enhance the effectiveness, credibility and legitimacy of the IMF. First, since Ministers and Governors play a primary role in establishing the strategic direction of the Fund, pursuing options for increasing Ministerial engagement with Fund issues will be essential. Second, a clarification of the roles and responsibilities of the various bodies in the IMF governance structure should be undertaken to enhance the accountability of the Executive Board and Fund management.

We also reaffirm our desire to see an open, transparent and merit-based management selection process introduced at the Fund whereby senior management is selected regardless of candidate nationality. Done in step with quota and Executive Board reform, this will go a long way towards effectively enhancing Fund legitimacy.